IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX REFERENCE NO. 415 OF 1988

M/s Piem Hotels Ltd. ... Applicant.

V/s.

The Commissioner of Income Tax ... Respondent.

Shri Ashok Kotangale for the applicant.

Shri F.B. Andhyarujina, Senior Counsel with P.C.Tripathi and Ms. Pallavi Divekar for the respondent.

CORAM : V.C.DAGA AND J.P. DEVADHAR, JJ.
DATED : 25.10.2005.

ORAL JUDGMENT: **(Per V.C.DAGA,J.)**

. This is a reference under section 256(1) of the Income Tax Act, 1961 ('The Act' for short) made by the Income Tax Appellate Tribunal, Bombay Bench, 'E', Bombay. ('Tribunal' for short) referring following two questions for the opinion of this Court; one at the instance of the assessee and, another at the behest of the Revenue, arising from its order dated 6.2.1986 passed in I.T.A. No. 1721/Bom/1986, for the A.Y. 1982-83 of which relevant accounting year ended on 31.3.1982.

At the instance of the Assessee

(1). Whether on the facts and in the circumstances of the case, the Income-tax Appellate Tribunal was right in law, in holding that the amount of Hotel Receipt Tax (HRT) collected by the petitioner company constituted trading receipts ?"

At the instance of the Revenue

(2). Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that for assessment year 1982-83 the assessee was entitled to a deduction of Rs. 84,95,504/- in respect of the Hotel Receipt Tax ?"

The Facts:

2. This reference relates to the amount collected under the provisions of the Hotel Receipt Act, 1980 ('HRT' Act) which received the assent of the Hon'ble President of India on 9th December 1980. This Act levied Hotel Receipt Tax (HRT) @ 15% of the chargeable receipts with effect from 1st February, 1981.

3. The assessee is engaged in the business of running chain of 5 star hotels. The assessee had collected hotel receipts tax in the sum of Rs. 14,55,241/- during the period 1.2.1981 to 31.3.1982. The present reference relates to the period 1.4.1981 to 31.3.1982, which was the relevant accounting year. During this period, the HRT collection was in the sum of Rs. 84,95,503. The assessee did not pay HRT collected and payable under the HRT Act but chose to challenge the constitutional validity of the said legislation before the Hon'ble Supreme Court of India along with various hotelliers as well as the Hotel Associations by way of writ petition.

The Hon'ble Supreme Court stayed operation of the said Act during the pendency of the writ petition subject to the condition that in the event of assessee failing in the petition, they shall be liable to pay HRT irrespective of the fact whether or not they had collected HRT from its customers.

4. The aforesaid order of stay was renewed from time to time and it operated during the pendency of the petition. Ultimately, validity of HRT Act was upheld by the Supreme Court.

5. The assessee during the pendency of the petition, had credited the amount received from its customers on account of hotel receipts tax ('HRT' for short) to a separate account that was shown under the Head of Other Liabilities and consolidated under the head of Sundry Creditors in the Balance sheet. Thus, the amount collected were not treated as a part of trading receipts and, accordingly, not routed through the Profit and Loss Account.

6. The Assessing Officer considered the HRT collected by the assessee as its trading receipt by placing reliance on the decision of the Apex Court in the case of Chowringhee Sales Bureau (87 ITR 542)and rejected the assessee's claim for deduction of a corresponding amount on the ground that no

legally enforceable liabiity had arisen since the operation of the HRT Act itself had been stayed by the Apex Court.

7. The Commissioner of Income Tax (Appeals) vide its order dated 6.2.2003 held that the HRT has been collected alongwith the sales made by the assessee on the regular day today basis in the course of the assessee's business. The same thus constituted a trading receipt and the accounting treatment given by the assessee is immaterial. The claim for deduction was also rejected since as per the Commissioner of Income Tax (Appeals); the Apex Court had granted stay on the operation of HRT Act and, therefore, there was no liability on the appellant to make payment of the HRT collected from the customers. The amount was thus held deductible as a business expense in the year in which the liability arises or the year in which it is discharged, depending upon method of accounting.

8. Being aggrieved by the aforesaid order of the CIT (A); an appeal was carried to the Tribunal. The Tribunal vide its order dated 6th February, 1987, held that the HRT collected by the assessee was not subject to diversion by over-riding title; the obligation to pay could not be discharged out of other receipts also. The same is, therefore, in the

nature of trading receipts. As regards corresponding deduction,l it was held that a liability had definitely arisen during the accounting year; the moment the taxable event i.e. receipt of room rent, took place. The liability was directed to be allowed as a deduction.

9. As pointed out hereinabove, the Apex Court on 2nd May 1989, upheld constitutional validity of the HRT Act in the decision rendered in the case of Elel Hotels and Investments Ltd. and anr. vs. Union of India (178 ITR 140), as a result thereof, the assessee discharged its liability during the year ended March 31,1990 and March 1991. The decision of the Supreme Court has resulted in the HRT Act being valid right from the day on which it received assent of the President of India along with various provisions relating inter alia; to changeability, deductibility in computing the profit and loss or gains of the business. Thus, the liability of the assessee to collect and pay HRT stood confirmed by the Supreme Court right from the inception of HRT Act as if HRT Act was in full force applicable to the assessee for the year under consideration.

10. Both the parties to the appeal sought reference to get the substantial questions of law

referred for the opinion of this Court. The Tribunal after hearing rival parties was pleased to refer to this Court, two substantial questions of law for opinion, extracted in the opening part of the judgment.

Submissions:

11. Shri Andhyarujina, Learned Senior Counsel appearing for the assessee relying upon provisions of section 21 of the HRT Act contends that amount of tax so collected ought to have been treated as receipt and the amount ought to have been held deductible from the profits and gains of the business of the hotel assessable for that assessment year. He relies on the judgment of the Apex Court in the case of **Jonnalla Narashimharao and Co. vs. C.I.T. (1993) 200 ITR 588 (SC).** In that case, the appellant had collected certain amount by way of sales tax describing it as "rusum" inasmuch as its liability to sales tax was disputed by it. The same was questioned in the various proceedings. It maintained its accounts on the mercantile system. The questions for consideration was whether or not the amount collected by the appellant in the name of 'rusum' was the income of the assessee, and whether or not the sales tax paid was allowable as a deduction in the relevant assessment year. High

Court held that amounts collected in the name of 'rusum' were income but were not deductible in the assessment year. The Apex Court reversed and held that the amounts collected in the name of 'rusum' constituted business receipts of the assessee.

12. Learned Senior Counsel for the assessee also relied upon decision of the Apex Court in the case of Kedarnath Jute Manufacturing Co.Ltd vs. CIT (1971) 82 ITR 363 (SC) to buttress his submission and to demonstrate correct legal position.

13. Learned Senior Counsel for the assessee further pressed into service another judgment of the Supreme Court in the case of CIT vs. Kalinga Tubes Ltd.(1996) 218 ITR 164. In that case, the assessee-company had manufactured and sold steel tubes. During the previous year relevant to the assessment year 1962-63 the assessee was held liable to pay sales tax under the Central Sales Tax Act. The Sales tax Officer completed the assessment in respect of the Assessment Year 1962-63 on March 31,1966 and demanded an additional amount of Rs.11,02,698/-. The assessee unsuccessfully carried appeal before first appellate authority and then filed 2nd appeal before the Sales Tax Tribunal. The Tribunal vide its order dated May 28, 1970, reduced the of additional sales tax to Rs. 2,22,161/-.

14. On the basis of the above order of the Tribunal, the respondent assessee in its Income tax return claimed deduction of the said amount as business expenditure in the assessment year 1971-72 The Income Tax Officer disallowed the said deduction. This was upheld by the Income tax Tribunal . However, the High Court on reference held that the assesssee was entitled to the deduction in the assessment year 1971-72. On the appeal, the Supreme Court held that liability to pay the Central Sales Tax arose or accrued on the basis of mercantile system of accounting followed by the assessee during the previous relevant to the assessment year 1962-63 The liability to pay quantified sales tax under the orders of the Sales Tax Officer accrued to the assessee for the A.Y. 1962-63. Although the assessee had challenged the same and ultimately got the liability to pay the sales tax for the A.Y. 1962-63, reduced in second appeal before the Sales tax Tribunal on May 28, 1970 to Rs. 2,22,161/- that would not affect the accrual of liability to pay sales tax of the basis of mercantile system of accounting. It was further held that even if it were held to be that the order of the Sales Tax Officer had merged in the order of the Sales Tax Tribunal that would not have created any impact on the question as to when the liability

to pay sales tax had accrued to the assessee on the basis of mercantile system of accounting and in which assesment year the claim for deduction under section 37 of the Act could not have been made by the assessee. The assessee was thus held not entitled to deduction of Rs. 2,22,161 towards sales tax liability for the assessment year 1971-72.

15. While deciding the above case the judgment of the Apex Court in the case of Kedarnath Jute Manufacturing Co. Ltd. (supra) was relied upon to reach to the conclusion that the assessee was following mercantile system of accounting in the case of sales tax payable by the assessee and the liability to pay sales tax would arise the moment tax event takes place attracting sales tax, as such the obligation to pay the sales tax arises at that stage and that any attempt to dispute liability to pay before any higher authority was irrelevant.

16. Learned Senior Counsel also relied upon judgment of this Court in the case of CIT vs. Central Provinces Manganese Ore Co. Ltd. (1978) 112 ITR 534, wherein this Court has held that if a statutory liability arises in a particular year, then an assessee maintaining books of accounts on the mercantile basis is entitled to claim deduction in the year in which the liability arises

notwithstanding the fact that the liabiity was disputed and no entries were made in his books of accounts. The mere fact that such a deduction was not claimed before the Income tax Officer was not of much significance. If the liability arises then a claim can be made bona fide at any stage before any higher authority, who is competent to grant relief. While taking this view, the Division Bench has relied upon judgment of the Madras High Court in the case of Pope the King Match Factory v. CIT (1963) 50 ITR 495. A similar view was taken by the Madras High Court which was approved by the Apex Court as laying down correct law.

17. The learned Senior Counsel for the petitioner based on the above precedents submits that notwithstanding the fact that the dispute having been raised as regards the amount to be paid by way of HRT or failure to make entries in the books of accounts is of no significance. If the statutory liability arises in a particular relevant year; then the assessee maintaining the books of accounts on mercantile system is entitled to claim deduction in the year in which the liability arises notwithstanding the fact that he has taken steps to dispute his liability, and, ultimately failed or omitted to make entries in the books of accounts.

18. In the above premises, according to the learned Senior Counsel, first question has to be answered in the affirmative i.e. in favour of the Revenue and second question needs to be answered in the negative i.e. in favour of the assessee and against the Revenue.

Per Contra:

19. Learned Counsel appearing for the Revenue submitted that the assessee collected the amount but it had not paid the same to Government as hotel receipt tax. On appeal by the assessee on a different issue, the Commissioner (Appeals) directed the Income Tax Officer to bring to tax the said sum by enhancing the assessment only on further appeal by the assessee. He placed reliance on the judgment of the Madras High Court in the case of C.I.T. vs. Hotel Srilekha (P) Ltd. 250 ITR 573.

Rejoinder:

20. In rejoinder, learned Senior Counsel appearing for the assessee tried to dinstinguish the view of the Madras High Court in the case of Hotel Srilekha (supra) and submitted that the said case came to be decided without reference to the provisions of the HRT Act. According to him, in

that case, the assessee had merely collected the amount but did not challenge the validity of the Act in any Court. He further submits that the said Act came into force on 1.4.1981 whereas period involved a in that case of Hotel Srilekha (P) Ltd. (supra) was 1981-82. In the said case, the only issue was whether amount collected was a trading receipt. The principles sought to be applied is based on the judgment of the Supreme Court related only to trading receipt collected and retained. He further submits that section 21 of the HRT Act was not at all considered as such said authority cannot be said to be an authority laying down correct law.

21. While reiterating his earlier submissions, learned Senior Counsel for the assessee submitted that liability in the case at hand was in the collection itself. He further submits that obligation to pay always existed in the interim order of the Apex Court. He, alternatively, submits that assuming it to be trade receipt, even then by virtue of section 21 of the Act, the same would be deductible in that year. He tried to press into service section 21 and tried to emphasis the words "deductible for that assessment year" appearing in the section. He, thus, submits that on the face of section 21 assessee is entitled to succeed in the Reference at hand.

Consideration:

22. Having heard rival parties, we are of the considered view that the facts involved in the present case are identical with that of the facts involved in the case of Jonnalia Narashimharao & Co. (cited supra), wherein the Apex Court has held that since the appellant therein had maintained its accounts on the mercantile basis, the amount collected as "rusum" were deductible as business expenditure for the A.Y. 1968-69, though they had not been remitted to the treasury in that year. In the case of Kedarnath Jute Manufacturing Co. Ltd. (supra) the Apex Court ruled that once it is held that the assessee was following mercantile system of accounting in the case of sales tax payable by the assessee, the liability to pay sales tax would accrue the moment the dealer made the sales which were subject to sales tax. The liability would not arise in case assessee had challenged validity of imposition of tax and obtained stay from the competent Court. However, in the case at hand while granting stay the Apex Court had made it clear that the assessee will have to discharge tax liability irrespective of the fact whether or not tax is collected by them from their customers. Therefore, statutory liability to pay was inbuilt in the

interim order granted by the Apex Court in favour of the petitioner.

23. In the above premises, (HRT) Tax collected by the assessee will have to be held as treating as trading receipt. This view shall also be in consonance with the text of section 21 of the HRT Act. The assessee will, thus be entitled to claim deduction of the amount of HRT to extent it was paid to discharge their liability under HRT Act.

24. For the reasons recorded hereinabove, we have no hesitation to answer the first question in favour of the Revenue and second question in favour of the assessee as indicated hereinabove.

. Reference accordingly stands answered with no order as to costs.

(J.P. DEVADHAR,J.) **(V.C. DAGA,J.)**